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# THE INFLATION OF CHINESE LEGAL TENDER

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## I. INTRODUCTION

Chinese legal tender notes, comprising those issued by the Central Bank of China, the Bank of China, the Bank of Communications, and the Farmers' Bank of China, have been tending in the direction of steady inflation since 1938. According to an announcement of the Chungking government, the total value of these notes in circulation at the end of June, 1940, reached a peak figure of \$ 3,962,000,000. This figure represented an increase of \$ 881,000,000, or 28.9%, over the total issue of \$ 3,081,000,000 registered at the end of the previous year and of \$ 1,335,000,000, or 43.3%, over the corresponding date for the preceding year. Compared again with the total issue registered at the end of July, 1937, or at the beginning of the present Sino-Japanese Conflict, this represented a treble increase. This is a most phenomenal rate of expansion. Such a heavy increase as was witnessed in the first half of 1940 strongly suggests the imminence of the collapse of the currency.

This inflation of *fapi*, or Chinese legal tender notes, just noted is in striking contrast to the deflation of the same currency enforced during the early stages of the conflict. This singular development is attributable largely to the nature of the currency itself, which was imposed upon *fapi* in the process of its inception and growth. Therefore, a study of the currency and its inflational tendencies should be preceded by a discussion of the peculiar characteristics of *fapi*, which may help to clear up the problems involved.

In a totalitarian war with a highly organized defense program, economic conflict necessarily entails a conflict

between the currencies involved. Thus *fapi* constitutes a most delicate factor in the present conflict, being an enemy currency, so far as the yen-linked currencies are concerned, which prevents the successful establishment of the East Asian New Order. At the same time it is the only currency with which to offer resistance insofar as the Chungking régime is concerned. As is well known, it is a currency based upon a gold-exchange standard, brought into existence by the Nationalist government in November, 1935, in response to the needs of Chinese national economy which had been realized ever since the end of the previous century. During the days of its inception the Manchoukuoan legal tender and the Bank of Chosen notes were already in circulation in certain parts of China, and accordingly *fapi* was destined first of all to come into conflict with yen currencies, as will be pointed out later. In the second place, while *fapi* was instituted as the gold standard legal tender of the Chinese government, so far as its operations were concerned, it was also linked with the English pound on the basis of a gold exchange established by hypothecating to England all the silver owned by the national treasury. These peculiar features of the *fapi* will be clearly brought to the fore in any historical analysis of the various developments that have taken place in connection with this currency.<sup>1)</sup>

Such being the basic nature of *fapi*, it is only natural that the course of development of the currency should be conditioned by these intrinsic features, requiring that the various phenomena relative to the currency be analyzed in their light. Of all the questions arising from the origin and growth of this Chinese legal tender, the most important today is its extraordinary inflation and the various concomitant problems arising in this connection. These are important inasmuch as *fapi* inflation differs greatly from monetary inflations that have taken place in other countries in Europe and America. The fact that despite the fall in

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1) K. Matsuoka, *Etalon de change or en Extrême-Orient*, 1939, pp. 95-112.

exchange value to  $4\frac{1}{2}$  pence, or less than one-third of the original rate of 1 shilling  $2\frac{1}{2}$  pence, it still enjoys public confidence as legal tender, can hardly be explained adequately by any theory appropriate to the highly developed capitalistic economies of Europe and America. This is an important point that requires further clarification. In our conclusion, this condition of *fapi* inflation finds a most conclusive explanation in the theory that the situation has resulted from the currency being circulated in an area in which an Asiatic mode of production prevails. What constitutes an Asiatic mode of production is a subject that has been discussed a good deal in the past, and no recapitulation is necessary here beyond a statement that there exist in the area in which *fapi* is in circulation certain uniquely Asiatic features that characterize the mode of production which are distinct from those prevailing in a more highly developed form of capitalistic production. It is unthinkable that the currency of a capitalistic state should continue to function and sustain public confidence despite a depreciation to less than a third of its normal value. That *fapi* continues to circulate under the circumstances just described is proof that its existence is regulated by a certain set of factors diverging widely from those obtaining in Western countries. Insofar as this phenomenon is concerned, therefore, what determines the ultimate character of *fapi* are the so-called "Asiatic factors of production". This course of argument can be more fully appreciated from the following analysis of the nature of *fapi*.

The so-called Asiatic mode of production accounts for the existence of certain uniquely Asiatic factors in China, particularly in connection with her semi-feudal or semi-colonial status. It is also responsible, inter alia, for determining the nature of the currency. To say that the Chinese mode of production is feudal is tantamount to saying that, in addition to being Asiatic as contrasted with the Western mode, it is actually in a pre-capitalistic stage of development, not being fully possessed of the characteristic capitalistic features either in form or essence. It is also semi-colonial

in that the gold exchange standard currency system, an aspect which had been anticipated ever since the end of the Ching dynasty, materialized not as a consequence of the financial strength of China, but under the aegis of British capital. Consequently, China lost her economic independence and became a sort of semi-colonial economic unit, dominated by British capital.

The fact that *fapi* gains its attributes as a consequence of the Asiatic mode of production and is operated within such an economy as above described explains why it possesses, like the amoeba, a kind of self-sustaining strength, to an extent unthinkable in other currencies operated within a more highly developed capitalistic economy. This fact explains also why *fapi* continues its existence under the dominance of British capital, inconsistently with a normal development of capitalistic economy and in a manner hostile to the yen currencies which are rapidly growing into currencies of the "*Grossraumordnung*" in East Asia. What is the nature of this inconsistency? It is only natural that China should recognize her position of minority in world economy and that she should strive to attain a higher level of national economy such as has been reached by the more advanced states. However, in an age of financial capitalism, in which world economy is dominated by the capital of Great Britain and the United-States of America, such an effort is merely a futile gesture insofar as it is hoped to achieve the desired progress by dependence upon the financial strength of these dominant states. Where the world situation is such that the political independence of a state is often threatened on account of loans accepted from another state, how can China hope to attain economic growth and independence through reliance upon foreign economic assistance? This is exactly the inconsistency that the Nationalist government has committed, in its effort to realize economic independence.

The basic nature of the Chinese legal tender has been determined by this background. It was this background that enabled the currency to acquire the status of legal tender

by overcoming the suspicion and distrust which the people felt toward it prior to the outbreak of the conflict, and to maintain its exchange value at 1 shilling 2½ pence during the first eight months of the anti-Japanese campaign and a relatively stable position even thereafter. In the face, however, of the subsequent ascendancy of the yen currencies achieved, as a result of a variety of measures since the beginning of the conflict, *fapi* was finally compelled to succumb and relinquish its fixed exchange value, which has since dropped to 4½ pence. It is a noteworthy fact, however, that it was still able to stabilize itself—although temporarily, of course—at a depreciated value. For even though its final collapse is generally considered merely a question of time, it is still uncertain whether it may to be anticipated as a proximate eventuality, under the present circumstances. To wait idly for its final downfall displays a lack of understanding of the problems involved. *Fapi* is an enemy currency, the destruction of which is possible only by means of an active support, in theory as well as in practice, of the new currency which is to replace it. In a period of transition, it is possible that the situation may develop in unexpected direction. But, unless active measures are undertaken to secure the destruction of *fapi* and the promotion of the new currency, the former may continue its amoeboid existence, because of certain semi-feudal features and the prevalence of a pre-capitalistic mode of production in China, even after the withdrawal of the British support or the disappearance from China of her semi-colonial influence. It is as foolish as seeking fish in the tree-tops to idly anticipate, without putting forth rigorous efforts, the fall of the old currency and the eventual automatic solution of the problems involved. Such inactivity is all the more reprehensible inasmuch as the Chungking government is making every effort to obtain American support to replace the waning British assistance. While we are not at liberty to discuss the effect of the proposed move, its possible outcome deserves our most careful consideration.

So far we have considered certain peculiar characteristics of *fapi* as currency. The meaning of *fapi* inflation, therefore, should be analyzed in the light of these basic considerations. In the following pages, we shall endeavour to discuss *fapi* inflation, first, as a currency of the Nationalist government and, second, as a pound-linked currency.

## II. INFLATION OF *FAPI* AS A CURRENCY OF THE NATIONALIST GOVERNMENT

Since the outbreak of the present Sino-Japanese dispute, the Nationalist government legal tender, which is now being rapidly crippled as an anti-yen-weapon, has changed status from the Nanking government's legal tender to that of the Chungking government. Along with this change, the policy pursued in support of this currency seems now to be rapidly approaching its last stage.

During the first stage of the conflict, *fapi* offered considerable resistance to the yen-linked currencies. It was only after it became the Chungking government currency that it began to reveal its semi-feudal nature with increasing clarity. This revelation was seen most specifically in connection with the problem of *fapi* inflation. For, while the Nanking currency was noteworthy for a deflationary rather than an inflationary tendency, it was only after *fapi* became the Chungking currency that it began to follow an inflationary trend. In view of these historic facts, our discussion will ignore the period of Shanghai warfare, when the Nanking currency showed a deflationary tendency on account of the promulgation of the Financial Security Law. Our treatment will cover the period in which the inconsistencies contained in the said law began to give birth to new regulations and measures such as the *wei-wah* note (foreign exchange) system of the Joint Reserve Board, the Loan and Discount Regulations for the Four Banks, the Joint Committee Loan and Discount Regulations, and the Supplementary Regulations of the Financial Security Law, up to the time when the Chinese



government removed itself to Chungking and commenced the work of developing the southwestern districts as provided by the Regulations relative to Financial Organization for Local Development.<sup>2)</sup>

The fiscal position of the Kuomintang government was always anything but prosperous throughout the Nanking period and has shown no improvement since its removal to Chungking. Therefore, the government was compelled to resort to currency inflation in pursuit of its policy of consolidating national unity through resistance to Japan and of developing Southwest China. It was inevitable that in the form of a currency circulating in a semi-colonial state, *fapi* should thus be exploited in wartime.

No exact figures are available to reveal the true fiscal position of the Chinese government after the outbreak of the China Affair. However, it can be roughly approximated from the fact that the total war budget for the years 1937-1939 was estimated at somewhere between \$ 2,500,000,000 and \$ 2,800,000,000 while, on the other hand, monthly war expenditures were reported to reach the level of some \$ 200,000,000.<sup>3)</sup> With regard to its revenues, the government lost certain major sources of its income such as the customs revenues and the salt tax and commodity taxes, which had yielded nearly 80% of its total receipts during the pre-Incident years. Moreover, with the steady decrease in other revenues along with a multiplication of lost territories, the government has begun to find itself in increasingly straightened financial conditions. This state of affairs was clearly evidenced by successive defaults as regards foreign indebtedness, such as the suspension in 1939 of interest payment on reconstruction bonds secured by the maritime customs revenues, the restriction and suspension of interest payments on foreign bonds secured by customs revenues and salt taxes declared on two occasions in 1939, and the proposal to the United States in

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2) Vide Sheng Mu-Chieh, Wartime Operations of the Bank of China.

3) Vide Chang Liu, Chinese Economy during the First Two years of the War.

1939 for the extension of loans and interest payment relative to flood relief bonds and wheat and cotton loan.

According to an investigation made at the end of 1938, the total value of bonds floated by the Nationalist government since the beginning of hostilities exceeds \$ 2,600,000. The principal subdivisions of these bonds consisted of blocks of \$ 500,000,000 each of patriotic bonds and national defense bonds, blocks of \$ 100,000,000 each of refugee relief bonds and *haikwan* gold bonds, and also blocks of £ 10,000,000 of *haikwan* gold pound bonds and \$ 50,000,000 of United States dollar bonds. But the results of the floatation of these bonds were far from satisfactory. Even E. Kann admitted that the total subscription to the patriotic bonds remained at about \$ 200,000,000, and this may suggest the fate of the other bonds.

That the Chungking government was thus compelled to pursue an inconsistent policy of seeking more funds by bond issues, on the one hand, while suspending interest payments, on the other, clearly testifies to the financial impoverishment of that government as well as to the general sterility of the bond-subscribing public. While some Chinese writers argued<sup>4)</sup> that bond issues of such dimensions designed to balance the national budget had little significance, such a statement should rather be interpreted as indicating that Chinese national economy is still in a semi-feudalistic and pre-capitalistic condition and lacks sufficient strength to meet modern requirement, even to this relatively insignificant extent. In practical operations, therefore, a good portion of these bonds were held by banks and served as security for further issues of bank-notes, to the natural intensification of the currency inflation.

The impoverishment of the Kuomintang government is seen also in its effort to acquire foreign loans, any increase of which would naturally result in further inflation of *fapi* — a point which will be raised later. The principal foreign

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4) Vide Chang Liu, *op. cit.*

loans offered so far to the Chungking régime comprise the American loan of \$ 25,000,000 known as "the tung oil loan," and of \$ 12,000,000 known as "the aircraft loan," and also an English loan of £ 10,000,000 known as "the *fapi* stabilization loan."

The effort of the Chungking government relative to its legal tender aims solely at raising funds for the prosecution of the war, the development of Southwest China and the acquisition of credits from foreign governments which have some interests in China. The results of such efforts, whenever successful, invariably bring about further inflation of its currency. Furthermore, the economic life of the unoccupied areas is now seriously crippled by a heavy excess of imports and an enormous purchases of war supplies carried out in utter disregard of the government's financial conditions. To aggravate the situation, remittances from Chinese emigrants abroad are also dwindling along with the loss of their home districts to Japanese occupation.<sup>5)</sup> Faced by such an adverse situation, *fapi* currency appears on the verge of collapse.

In addition to these factors of *fapi* inflation, there are certain other elements which accelerate this tendency, namely, increasing exactions of war expenditures from local sources and the consequent restoration of the privilege of note issue to local banks, and an increased issue of small-denomination notes. The decrease in government revenues became still more radical after the retreat of the government into the remote hinterland, and its tax receipts were reported to be hardly more than \$ 100,000,000, with total combined revenues of approximately \$ 400,000,000 to \$ 500,000,000.<sup>6)</sup> Therefore, while war expenditures may not have shown any increase since the removal of the government to Chungking, on

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5) According to "Finance and Commerce", the total remittances from Chinese emigrants abroad reached \$ 600,000,000, of which \$ 120,000,000 was contributed directly to the Chiang Kai-shek government. It is reported, however, that this amount includes the proceeds of gold bonds issued in 1938.

6) Research Bureau, South Manchuria Railway Co., *Chinese Economic Yearbook*, 1940, p. 579.

account of curtailment in the scale of warfare, the government was in no position to raise the entire revenues single-handed, and was compelled to shift this burden to local quarters. It was for this reason that a number of banks in Szechwan and Yunnan Provinces were reaccorded the privilege of note issue, which had previously been withdrawn by the government, and were thereby enabled to raise war funds. However, the provinces upon which these financial responsibilities have been placed, whether they happen to be the southwestern districts (comprising Szechwan, Sikang, Yunnan, Kweichow and Kwangsi provinces) or the northwestern districts (comprising Shensi, Kansu, Ningsia, Tsinghai and Sinkiang Provinces) are economically still undeveloped, and hence considerable new funds were required for their exploitation, as they still belong to pre-capitalistic areas. As for the issue of small-denomination notes, it was reported that this measure was resorted to in order to replace the small coins that had been withdrawn from circulation and in consideration of the government's position toward the creditor nations, as it could be carried out without consulting them. Be that as it may, all these measures resulted directly or indirectly in an increased issue of *fapi* notes.

The money issued by a state for the prosecution of a war and that issued to meet popular need, when considered in terms of quantity, do not always stand in harmony. On the contrary, these two phases of a currency more often than not come into conflict. For the purpose of conducting a war, a government usually tends to issue a large quantity of money regardless of its gold reserves, while for popular needs it does not favour excessive issue. It is naturally superfluous to point out that the prosecution of a modern war requires an enormous expenditure; and this is true even in a state like China which is still in a relatively undeveloped condition. It is for this reason that the Chinese government has found it difficult to pursue its wartime monetary policy without affecting the popular aspect of its currency.

The Chiang Kai-shek régime prepared a wartime finan-

cial program as outlined in the "Wartime Fiscal Measures of the National Government" even before the outbreak of the present conflict. As soon, however, as it faced the necessity of carrying out these measures, it was obliged to place the emphasis upon monetary operations for war purposes and to abandon its deflationary policy, pursued in the initial stage of the strife. Meanwhile, the yen currencies made steady inroads at the expense of the Chungking dollars. Furthermore, the gradual retreat of British capital from China along with the aggravation of the war situation in Europe caused the Chungking dollar to lose its importance *pari pasu* as a popular currency and to become active as a war measure.

It is now apparent that the only means by which the *fapi* currency supports itself is through the exploitation of the resources of Southwest China, i. e., when not depending upon foreign assistance. As it has been stated, *fapi* is a pound-linked currency, whose value is determined by the amount of specie, or its equivalent, held abroad by the Chinese government. However, its value as a currency is dependent ultimately upon economic productivity within the country. Therefore, in the face of decreasing overseas specie holding and the growing difficulty in obtaining foreign credits, the Chinese government of necessity had to resort to economic reorganization and the mobilization of all industrial resources in the unoccupied territories. The exploitation of the southwestern resources was the enterprise which was to be carried through with this end in view. It is an interesting fact, especially from the point of view of national defense, that nearly 90% of China's industrial productivity was located in such coastal centers as Shanghai (which accounted for nearly 50% of her productivity), Tientsin and Tsingtao and their neighborhood, while the resources of Southwest China, which were so invulnerably situated from a strategic and defensive point of view, were entirely neglected. While coal and iron deposits in these localities are by no means abundant, the districts promise considerable industrial possibilities

(particularly the localities around Chungking in Eastern Szechwan Province). Moreover, the territories under discussion abound in such non-ferrous products as tin, copper, mercury and gold, and also in such farm products as vegetable oils, bristles, hides, tea, silk, etc. It is a most significant fact that, despite war conditions and numerous other difficulties, machines and other supplies to the tune of over 40,000 tons have been and are being hauled over inland routes of a length of several thousand miles for the development of these districts and that they comprise such wide divergences in category as weaving machines, metal tools, wireless machines, earthenware, glassware for chemical industries, provisions, printing machines and the like. Thus, Southwest China should now be regarded as new industrial center developed for the purposes of economic defense.

In spite of such aims and projects, however, the actual results of the enterprise to date would seem to remain at a relatively insignificant level. Hence, so far as the future tendency of the value of the inflated Chungking dollar is concerned, the problem lies more directly upon the future progress of inflation rather than upon the ultimate source from which the currency will derive its value.

From a technical point of view, it may be observed that the maintenance of the value of *fapi* has been attempted by a negative procedure designed to prevent its fall instead of by positive measures directed towards enhancing its value. This has been due to the fact that *fapi* has had to defend itself against the threat of the yen currencies even while the exploitation of the southwestern resources was in progress. The protective measures adopted for this end took the form of a foreign exchange quota system consisting of the Foreign Exchange Clearing Law and the Regulations for the Purchase of Foreign Exchange. These regulations were put into effect for the purpose of controlling foreign funds which became necessary in consequence of *fapi* inflation, and purported to promote the acquisition of foreign funds and to prepare for the launching of the Federal Reserve Bank of China

proposed by the Provisional Government at Peking. In spite of these regulations, quota distribution of exchange at a fixed rate could not be continued for any considerable length of time, the value of *fapi* having declined from 1 shilling 2½ pence to 8 pence after June, 1938. Furthermore, the foreign exchange quota system was practically invalidated since the exchange sold did not exceed 1 % of the total amount applied for. As a result of these developments, the privilege of supplying foreign exchange came to be monopolized by the Hongkong & Shanghai Banking Corporation, who thereafter operated foreign exchange control involving the control of *fapi* itself, under its own political and economic policies and at the expense of the Chinese public.

The right to handle foreign exchange thus came to be exercised by the Hongkong & Shanghai Banking Corporation. Under the circumstances, the Chungking government was compelled to discard its old monetary policy of preventing further inflation resulting from a shortage of foreign funds and to adopt a more positive policy of sustaining the value of *fapi* by means of enhanced productivity through exploitation of the southwestern resources. As a result, its program for commodity control had to be extended beyond the control of exports to the control of imports as well. In other words, in order to maintain the internal and external values of its currency, the Chiang Kai-shek government now found it necessary to revise its foreign trade operations and to stabilize the value of the currency on the basis of productivity to be developed by the southwestern economic project.

While such an attempt is legitimate as a project, it requires an adequate supply of funds, and the effort to raise the necessary funds will, in turn, prompt further inflation of the currency. The districts in question are economically more backward than most other parts of China, on account of the presence of many semi-feudal factors, and hence the funds supplied for the project inevitably seem to take on

the same hue. The fact that the project failed to draw sufficient investments from those business leaders of Shanghai who had made tour of investigation of the districts, and from other Chinese sources, seems to indicate a certain discrepancy as between the project itself and the success that has been achieved so far in the enterprise.

It is apparent from the foregoing discussion that the Chungking legal tender as a war currency is in a state of inflation as a result of the impoverishment of the government coffers, almost complete loss of revenues from the principal maritime customs of the country and the general deterioration of domestic productivity. It can be stated, however, that as war expenditures may not show any further marked increase, on account of absence of large scale military campaigns, the scale of the southwestern development need not be excessively extended. From such a point of view, the question that remains is whether the value of *fapi* will eventually fall so far as to discredit the currency entirely.

Numerically considered the inflation of Chungking dollars has advanced by leaps and bounds as indicated above. Geographically speaking, however, the extent of inflation is by no means uniform, some difference being observed as between the so-called "occupied" and "unoccupied" territories. According to popular estimates, the total amount of *fapi* in circulation is said by some quarters to be about \$ 7,000,000, 000, while by others to be no less than \$ 5,000,000,000. Geographical differences are also observed in the price indexes, which indicate the relationship between currency and commodities. For example, price indexes in Kunming are higher than those in Shanghai or Chungking. This is due partly to government restriction upon the domestic circulation of commodities and currency, and partly to the failure of the government to enforce its regulations throughout the country on account of the extent of the territory involved. From the point of view of the domestic value of the currency, such a state of affairs constitutes a threat to the livelihood of the 400,000,000 inhabitants of China, since



it is uncertain to what extent the public will be able to bear the burden of heavy inflation. The recent general strike in Shanghai can be regarded as one of the symptoms of the fear and unrest felt by the people in general.

### III. INFLATION OF *FAPI* AS A POUND-LINKED CURRENCY

Chinese legal tender notes came into existence as a semi-colonial currency supported by British capital. In view of its origin, *fapi* may therefore be regarded as a currency linked with the English pound. It is a well-known fact that Sir Leith-Ross, who became famous in connection with the inception of the Chinese currency system, has referred to *fapi* as "my baby". However, the manner in which the English currency supports the Chinese is full of subtle nuances and complex details. For example, during the pre-Incident days and up to a certain period after the outbreak of the conflict, the English financial backing of the Chinese currency was extended genteelly, to all outward appearances, and even such operations as the sale of foreign exchange were left in the hand of the Chinese government. It was only after August, 1938, when the Hongkong & Shanghai Banking Corporation superseded the Chinese government as sellers of foreign exchange, that the Chinese currency began to reveal its true character as a pound-linked currency. Between that date and the following July, it appeared as though the Nationalist government had entrusted the entire gamut of foreign exchange operations first to the Hongkong & Shanghai Banking Corporation and subsequently to the Anglo-Chinese Joint Exchange Stabilization Fund Committee; and here again the Chinese currency clearly disclosed its link with the English currency. An analysis of these processes should provide a highly intriguing narrative of the relationship between the two currencies.

The outcome of the transfer of foreign exchange operations, however, was not very satisfactory, contrary to expect-

tations, and the foreign funds of the Nationalist government were indirectly sold out by the Hongkong & Shanghai Bank, as was discussed previously. In consequence, the government again resorted to more active foreign exchange operations, endeavouring to bolster the position of *fapi* by a closer linkage with the English currency, and to readjust the monetary system to suit the military campaign. The effort in this direction manifested itself in a government plan to reorganize its foreign trade program with a view to acquiring more foreign funds by means of the economic development of the southwestern districts.

Because of its link with English currency, the Chinese currency is destined to receive the political and economic assistance of Britain, and this inevitably places China under the dominance of this capitalistic state. Therefore, insofar as the political and economic interests of Britain remain in harmony with those of the Chungking government, the currency operations of China can be carried out without much friction. But, as soon as there shall appear any discrepancy between these interests, the more dominant capitalistic interests will begin to claim preference of their own right and interest.

*Fapi* inflation can be defined accurately by yet another feature of the currency, namely, the "semi-colonial" character of the *fapi*. We call it a "semi-colonial" currency inasmuch as British capitalists have identified their interests with those of the Nationalist government and support the currency so long as there exists a harmony between the interests involved. According to one writer, "on the very day on which the Chinese government promulgated the new currency system, the British Ambassador to China issued a proclamation, declaring that Chinese sovereignty should be respected, and prohibiting British nationals and institutions in China from using silver for the discharge of their obligations. At the same time, both the Hongkong & Shanghai Banking Corporation and the Chartered Bank of India, China, and Australia agreed to convert their silver holdings into the new

Chinese legal tender notes.<sup>7)</sup> In this connection, attention should be called to the fact that the British government pursued its activities with circumspection, considering it inadvisable to excite public attention by overt action. Hence, as soon as the position of *fapi* became unfavorable, with consequent disadvantage of their own interests, (because of the repudiation of *fapi*, for example, by the new northern government in Peking), the British government began to assume a more clearly-defined attitude. Such changes in British policies and attitudes were more distinctly observable as soon as the value of *fapi* took a downward trend, to the consequent derangement of foreign trade markets and to the disadvantage of British trade with China. By making use of abundant capital, she attempted to support *fapi* which sacrificing the interests of China. It is a well-known fact that as soon as the depreciation of *fapi* began to be widely discussed, compelling the Chinese government to prohibit the sale of foreign currency to the Chinese people, English capital invested in China quickly escaped out of the country, in violation of the Chinese government regulations. Eventually it was the Chinese public which was compelled to bear the burden of these restrictions and to suffer the soaring cost of living resulting from the depreciation of *fapi* and the consequent rise in the price of imports. It is, of course, possible that the depreciation of *fapi* brought about an increase in export trade, but whatever advantage is derived from such an increase is normally monopolized by capitalistic interests and is unavailable to the people in general. Therefore, it is the populace alone that ultimately bears the burden of currency depreciation in the form of higher prices of imports and the concomitant rise in the prices of all commodities.

Such depreciation of currency as just described led the Nationalist government that controlled the war currency into a state of impoverishment on account of the higher prices of the war supplies imported and an increase in the foreign

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7) Ho Han-Chih, Economic Structure of China (in Chinese) p. 82.

currency payments. This same process, as seen from the stand-point of a popular currency, inevitably resulted in an intensification of *fapi* inflation. It was reported, however, that since an excess issue of *fapi* was restricted by foreign intervention, the Chinese government had resorted to the method of issuing a large amount of small-denomination notes, particularly those of the Farmers' Bank.

Thus the privilege of supplying foreign exchange against *fapi*, which is the most important factor in determining the external value of a currency, is at the disposal of Great Britain. In case, therefore, Britain should be averse to selling foreign currency against *fapi* and the Nationalist government in turn fails to acquire a sufficient quantity of foreign funds, the external value of that currency will inevitably fall to such a marginal figure as may be dictated by the economic productivity at the command of the Chinese government. *Fapi* inflation will be intensified to this extent, and here again the burden of rising prices will be shifted to the public in general.

It was only natural that the Chinese government should endeavoured to secure its foreign currency reserves by enforcing foreign exchange control regulations and subsequently foreign trade control regulations. Nevertheless, it was impossible to realize the full benefit of these regulations insofar as Shanghai, China's largest foreign trade center, was dominated by the foreign concessions, which in turn were controlled by foreign capital and Chinese comprador capital. Under the circumstances, the acquisition of foreign currency balances was to be achieved through increased production of tung oil, tea, mining products, etc., and by means of exploitation of southwestern resources.<sup>8)</sup>

The degree of productivity developed by the southwestern

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8) It is a noteworthy fact that commodities thus produced and accumulated were shipped or smuggled out of the country first through Shanghai or Hongkong and later through Hongkong alone in order to be converted into foreign funds to sustain the value of *fapi*.

project, of which mention has been made, will determine the extent to which the value of the Chinese currency will fall. Therefore, the declared project of the Chinese government to increase the production and the exportation of tung oil and tea as a means of acquiring large holdings of foreign currency represents the last resort of that government in an effort to sustain the external value of its currency.<sup>9)</sup> As a practical problem, however, the success that can be achieved in this respect depends largely upon the steps by which it is sought to carry out the project, and it appears that the plan put into effect with a view to realizing this particular objective does not arouse undue optimism.

There is an intimate relationship also between *fapi* inflation and the "hot money" that escaped to such foreign markets as Hongkong and Singapore on account of *fapi* depreciation and in violation of government regulations, and migrated thereafter from one international market to another in search of security. When the value of *fapi* began to decline, substantial funds owned by both foreigners and Chinese took flight to Hongkong and Singapore and other safe markets, and subsequently to Manila and Shanghai as the first markets were placed under British exchange control as a result of the outbreak of the second European War. Of these funds, those which migrated to Shanghai, totaling about \$1,500,000,000, are considered to have greatly intensified *fapi* inflation in that market. Despite the government's desire to keep these funds on long-term deposit, they were steadily converted into commodities in line with the preponderant trend of the day, and further aggravated the currency inflation in Shanghai. In fact, the commodity price index in that center rose from the base figure of July, 1937, or at the beginning of the Sino-Japanese conflict, to 262 in February, 1940.

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9) Chinese government institutions organized for the promotion of international trade comprised the Chinese Foreign Trade Commission stationed in London, the Chinese Trust Co., the Southwestern Transportation Co., the Chinese Tea Co., the Chinese Vegetable Oil Co., etc.

Unable to check the progress of this downward movement in its currency, the Chinese government lowered the commercial exchange rate for *fapi* from 7 pence to 4½ pence. While it appears that this step has been taken in order to promote export trade, the devaluation appears to be more significance as a gesture toward other states, in regard to the southwestern project.

For the reasons above stated, the external value of Chinese currency is determined by circumstances under British control. Therefore, the exchange value of the currency was maintained at the original rate until British capital invested in China was withdrawn from that country, and new parities were established thereafter at such points as to insure Britain's security in pursuing her foreign trade activities in China. Even though such manipulations were effected with extreme soundness, the results were nevertheless achieved at the expense of the Chinese public, as has been stated above. Theoretically, we would usually associate the situation resulting from such operations with the so-called exchange inflation. In reality, however, the exchange operations were carried out by the Hongkong & Shanghai Banking Corporation with such extreme cleverness as to avoid giving an impression that they were among those responsible for *fapi* inflation.

In view of the intrinsic character of the Chinese currency, and especially because of its semi-colonial nature, it is beyond doubt that the cause of *fapi* inflation is greatly aggravated by the nature of the support given by the English currency. Even where the problems of inflation appear to be connected with those of internal value, they may be ultimately traced to the question of external value. That the changes in *fapi* inflation have occurred in harmony with the changes in the exchange value of the currency is a question that requires careful consideration. As an illustration of this conclusion, it can be pointed out that when the exchange rate of *fapi* dropped to 6 pence in June, 1939, the total issue of the currency reached the \$ 2,600,000,000 level.

## IV. CONCLUSION

Each of the two phases of Chinese currency discussed above is independently capable of giving rise to currency inflation. Several large scale military campaigns by an economically straitened semi-feudalistic state against a more advanced enemy; prolonged warfare though on a lesser scale; provision of a currency necessary for such military campaigns; raising of funds through foreign loans by a semi-colonial state that relies upon the economic strength, especially the munitions industries, of other states, and the consequent exchange control due to exhaustion of foreign fund reserves and the decline of the exchange value of domestic currency; devaluation of the currency as a last resort to cope with the threat of enemy currencies; the resultant rise in prices of certain imports and the concomitant advance in commodity prices in general—these facts formed a series of events in the face of which it was impossible to prevent *fapi* inflation.

A closer examination of these causes will probably reveal that, of these features of the Chinese currency, the latter, or the semi-colonial aspect, is more largely responsible for the present currency inflation than the former, namely, the semi-feudal nature of the *fapi*. This particular cause of inflation will probably persist so long as the currency remains in existence. For even though the danger of inflation resulting from the semi-feudal nature of the currency should by no means be underestimated, its extent is determined by such extraneous factors as the productivity which may be developed in the southwestern districts. On the other hand, so long as the semi-colonial nature of *fapi* arises from the dependence of the currency upon British capital, the danger from this particular cause is the greater, since the capitalistic interests will display persistent efforts for the acquisition of profit against the Chinese government. Since the outbreak of the second European War, Great Britain has considerably reduced these capitalistic activities in China to make way

for the advance of American capital. However, so long as the activities of these two states are guided by capitalistic principles, the relationship of each state to the Chinese currency will probably remain identical. It follows, therefore, that insofar as these capitalistic states take advantage of the semi-colonial status of Chinese economy and make use of the semi-colonial nature of *fapi* as the basis of their financial activities in China, they will influence the monetary policies of that country to such an effect that they can avail themselves of the benefit of *fapi* inflation. Therefore, it is the "semi-colonial" character of *fapi* rather than its "semi-feudal" feature, that will determine the fate of the currency in the future.

This same argument can be applied to the question of the new currency. It is not the automatic collapse of *fapi* through inflation, but the inception and growth of a new currency to be issued by the new government, through which we anticipate a solution of the problems of *fapi*. In issuing such a new currency, every effort should be made to prevent the emergence of the familiar features of the *fapi*. In this sense, Japan's economic structure is seen to be moving in the right direction, at least in principle, to render support to the new currency of the new government, by eliminating the old capitalistic elements and reorganizing itself in line with new economic principles, although the essence and the process of the new structure are subject to further scrutiny.

In the present treatise we have dealt only with the salient aspects of *fapi* inflation to the exclusion of certain more latent factors. This does not mean that *fapi* inflation is devoid of the latent aspects or that they may be ignored. On the contrary, it is expected that in such a semi-feudal economy as that of China, currency inflation will inevitably involve many latent elements. However, a study of these problems must be left until another opportunity presents itself.